ILLINOIS ENERGY SOLUTIONS

COMMENTS OF THE CONSTELLATION ENERGY GROUP COMPANIES

On June 29, 2006, Chairman Charles Box of the Illinois Commerce Commission ("Commission") issued a Request for Comment ("Chairman's Request") as part of the Commission's Illinois Energy Solutions forum. The Chairman's Request asked parties to comment on the value of an educational campaign in advance of the expiration of rate caps in order to educate customers on how to best manage their budgets.[1] The Chairman's Request also asked for comments regarding educating customers to encourage conservation as a strategy for coping with higher energy costs.[2]

Constellation Energy Commodities Group, Inc., Constellation Generation Group, LLC and Constellation NewEnergy, Inc. (collectively, "Constellation") commend Chairman Box, and the Commission as a whole, for their foresight and initiative to address these issues and appreciates the opportunity to offer these comments. Constellation agrees that consumer education programs initiated well in advance of the expiration of rate caps can help customers to plan for and adjust to changes in energy prices. The Commission can and should play an important role in educating customers, particularly residential customers and low income customers, about how electricity markets work, the factors that contribute to energy prices, and how customers can help manage their energy prices. The Commission has in the past, and can again, play an important role in educating customers about their ability to select alternative retail

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[1] *See* Request for Comments, dated June 29, 2006
[2] *See id*.

electric suppliers and about simple conservation measures. Constellation has not attempted to address all questions or issues raised in the Chairman's Request. Constellation's failure to address any question or any provisions of the Chairman's Request should not be misconstrued as support for or indifference to such matters. Accordingly, Constellation reserves the right to submit additional or different comments on the remaining questions or in response to comments submitted by other stakeholders.

I. INTRODUCTION AND BACKGROUND

A. The interest of the Constellation Companies

Constellation NewEnergy, Inc. ("Constellation NewEnergy") is licensed or certified to act as an alternative retail electric supplier to serve customers located in more than 20 states and provinces throughout the United States and Canada. In North America, Constellation NewEnergy has over 15,500 MW of load under contract with over 10,000 retail customers. In Illinois, Constellation NewEnergy is a certified Alternative Retail Electric Supplier ("ARES" or "RES") to serve non-residential customers with annual demands greater than 15,000 kWh in the service territories of Commonwealth Edison ("ComEd"), AmerenIP, AmerenCIPS, and AmerenCILCO. Constellation NewEnergy employs more than fifty people in its Chicago office. In addition, through its Gas Division, Constellation NewEnergy also provides natural gas service to over 700 commercial and industrial customers in the State of Illinois.

Constellation Energy Commodities Group, Inc. ("CCG") is the nation's largest wholesale electricity supplier. CCG has participated in numerous wholesale procurement proceedings, including those in New Jersey, Maryland, the District of Columbia,

Massachusetts, and Maine; and provides many electric utilities and municipalities throughout the U.S. with their electricity needs.

Affiliates of Constellation Generation Group, LLC ("CGG") own and operate two generating plants in Illinois: the Holland Energy plant in Effingham County and the University Park Energy plant in University Park. CGG employs approximately 30 employees on-site at both plants.

Constellation has been a leader in the development of competitive energy markets across North America. Our experience in competitive energy markets, outstanding customer service, specialized products and services, and the strong values behind our business have made us the supplier of choice to many of North America's largest corporations and most demanding energy users.

B. Background on Illinois Retail Electric Market

On January 2, 2007, the electric generation rate caps expire in Illinois.[3] The bundled service electric generation rates for Commonwealth Edison Company were last set in 1995 and, under the Electric Customer Choice and Rate Relief Law of 1997; the rates for residential consumers were reduced by roughly 20% and then frozen.[4] Although higher prices in 2007 are not an absolute certainty, recent energy price data indicate a likelihood that electricity prices will be above the existing electricity rate caps.[5] There are a number of factors that are contributing to the recent increases in energy prices,

[3] *See* 220 ILCS 5/16-102, 16-111(a).
[4] *See* 220 ILCS 5/16-111(b).
[5] *See* http://www.eia.doe.gov/emeu/steo/pub/contents.html

including a sharp increase in fuel costs, increasing transmission congestion, and growing demand. Many of these factors are macroeconomic and difficult to "control."

Constellation appreciates and supports the Commission's foresight into ways to help manage or mitigate the impact of any increase in electricity prices. Advanced efforts to educate consumers and encourage marketplace enhancements will play critical roles in moderating electricity prices in the longer term. Experience has shown that **all** consumers are better served if action is taken now rather than "after the fact" attempts at price mitigation. Such post-expiration measures have proven to be far less effective in ensuring customers receive the type of certainty and price stability expected from the marketplace.

At the onset, it bears noting that Illinois is not unique in facing rising price challenges. Surrounding markets and jurisdictions have or will confront the same issue. In consideration of this, the ICC should note that the core of any successful, growing economy has to be an affordable and plentiful supply of energy, diversity in its production to ensure flexibility to changes in global influences, and sensitivity to the growing challenges to the environment. Indeed, many of the circumstances, such as rising fuel costs and changing transmission congestion patterns, leading to rising prices are not unique to Illinois. In fact, many of these factors such as fuel costs are no longer just driven by domestic or regional demand, but are influenced substantially by international demand (particularly in Asia) and geopolitical events. These factors affect other nations and states as well as adjacent power systems. This growing interdependence of national and international energy commodities markets plus the interconnected nature of the national electricity system means that Illinois' decisions to mitigate retail price

impacts should not be made in isolation. Therefore, Constellation believes that all stakeholders must consider all the factors at work in price formation and work together in order to maintain and foster transparent, competitive wholesale and retail markets in Illinois that will allow wholesale and retail electric suppliers to manage these risks for Illinois' consumers.

II.

SPECIFIC COMMENTS

Constellation will address several, but not all, of the issues that were raised in the Chairman's Request. Additionally, Constellation will address other potential issues related to managing the impact of future price volatility and potential rate increases. Through its comments, Constellation urges the Commission to carefully maintain the integrity, transparency, and competitiveness of wholesale and retail markets as the best way to mitigate potential price increases, if any, that consumers may face upon the expiration of rate caps. Specifically, it's critical that the ICC ensure that risks are appropriately identified, introduced, and balanced between customers and wholesale and retail electric suppliers. This risk balance is an important feature considering that at this point in time, due to various market and technical limitations, wholesale and retail electric suppliers should be assumed to be more capable of managing these risks than individual customers. Furthermore, Constellation believes that competitive markets function most efficiently when they reflect demand and supply dynamics and are not driven towards a particular outcome through regulatory or political intervention.

A. SHORT-TERM SOLUTIONS

As noted above, Illinois is not unique in facing rising price challenges. Due to the growing interdependence of national energy markets, decisions in Illinois to educate consumers and to manage retail price impacts should not be made in isolation of these broader issues.

1. Customer Education Efforts Are Key – Questions 1, 2, 3, 4, 5

Constellation believes that consumer education about changes in the electricity market and its consequences is essential. Providing general information on prevailing market conditions will help familiarize consumers to these issues. By ensuring that consumers are more aware, and have more notice of major trends and developments in energy markets, the Commission would well serve customers in responding to changing prices. The mere initiation of the Illinois Energy Solutions forum is an important first step to help educate consumers about their energy bills.

Efforts should begin now to send customers price signals and improve price transparency for all customers, but particularly, large commercial and industrial customers. These price signals may already be provided to large commercial and industrial consumers on an hourly or monthly basis.

Analysis regarding the potential impact to residential customer bills that is accompanied by detailed explanation would be an important component to any consumer education program. Care, however, should be taken not to "predict" prices or market developments. After all, in a competitive market, prices inevitably rise and fall. It simply is not possible for regulators (or anyone else) to accurately predict the perfect moment to buy or sell at the lowest possible price. Therefore, the Commission should

focus its efforts on creating stable and predictable market rules designed to establish default service procurement, as well as policies that promote the development of competitive retail markets. Chief amongst these policies should be an emphasis on ensuring appropriate levels of price transparency so that consumers can make better decisions and suppliers can better hedge the risks of the market.

All interested stakeholders have a role in the education process. Constellation supports the initiation of a workshop process to provide interested parties with the opportunity to provide input on how educational materials should be designed, what topics should be covered, and how best to disseminate such materials. We believe that there is tremendous value to the initiation of such a workshop process in order to focus on changing market conditions and price variability.

For smaller commercial and residential customers, we recommend general information be made available as soon as possible and conveyed repeatedly. For larger customers, who are increasingly accustomed to analyzing and managing energy costs, the focus should be more on maintaining transparency in the utility rate structure and ensuring that large customers actually "see" market impacts. Further, we recommend any consumer education program fairly represent all aspects of the market, including competitive retail suppliers, the critical role of transparent and liquid wholesale markets, and the importance of continued investment in new generation infrastructure.

Further, the Organization of PJM States, Inc. ("OPSI") and the Organization of MISO States, Inc. ("OMS") could and should act as clearinghouses amongst state regulators for regional ideas for planning, sharing education efforts, and coordination of specific actions that address wholesale market matters. The OPSI and OMS consist of

representatives of various state agencies from the states within the PJM and MISO footprints, respectively, and therefore serve an important regional function. Indeed, the Commission has actively participated in both organizations. We recommend that the Commission explore additional ways of maximizing communication and actions within the OPSI and OMS frameworks.

2. Demand Response Programs – Question 10

In Illinois, Constellation NewEnergy offers an Incremental Incentive Curtailment Program that presents commercial and industrial customers with the opportunity to earn monetary compensation for voluntarily reducing electricity use (i.e., curtailment) during the peak summer electricity usage period. The compensation that a customer receives under the program is triggered when either: (a) ComEd initiates a curtailment period; or (b) Constellation NewEnergy initiates a curtailment period. It has been our experience that commercial and industrial customers have shown great interest in participating in this type of program.

While price signals are important for encouraging certain behavior, consumers also need tools to respond to price signals. To that end, we encourage further development of the PJM demand response programs that are already in place for commercial and industrial customers.

3. Role of Digital Technology – Question 13

Constellation believes that market forces are ultimately the best drivers of technological innovation and fuel diversity. Price signals are important for encouraging certain behavior, but consumers also need tools to respond to price signals. Web-based

information products and services provide powerful energy management tools that can help foster an even broader set of digital improvements and, at the same time, help generate the savings to pay for those improvements. By enabling customers to be proactive rather than reactive, these tools can enable more dynamic pricing, better energy management, the use of distributed resources, and lower customer energy bills. Digital age products and burgeoning services can increase the elasticity of demand for electricity, increase worker productivity, and stimulate the economy.

B. LONGER-TERM SOLUTIONS

1. Consumer Education - Questions 1-3

Overall the Commission should strive for a long-term solution that attempts to ensure consumers are more aware, and have more notice of major trends and developments in electric industry pricing. Such a goal would well serve customers in responding to changing prices. As part of this longer-term strategy, consumer education about the wholesale energy markets would be beneficial. If the Commission decides to implement a workshop (and Constellation believes that it should), this should be an additional area upon which stakeholders should focus.

As part of the longer-term strategy, the Commission should also consider what additional steps are needed to complete the transition to retail competitive markets in Illinois. The fact that the Commission is asking these questions now means that the Commission is well positioned to avoid some of the turmoil confronting customers and policy makers in other jurisdictions that are facing the expiration of long-standing price caps as world energy prices rise. As the Commission is aware, long-standing retail price caps have insulated customers from the effects of rising energy prices and, in a rising

price environment, preclude entry by new market participants.[6] Thus, the real challenge facing the Commission is to avoid unnecessary rate shock while continuing to promote the development of robust competitive markets that will ultimately provide the best way for customers to manage energy costs. A good example of how the Commission has faced this challenge and chosen a market friendly approach to avoiding rate shock is the use of three year rolling products in the competitive procurement programs for Ameren and ComEd.

While customers everywhere are facing increasing energy costs, it is undisputed that transparent, well-functioning competitive markets put downward pressure on prices and provide efficiency and environmental benefits to consumers.[7] In evaluating what options to pursue, the Commission's primary goals must be to ensure that market forces are allowed to work and to foster competition. However, Constellation cautions the Commission against trying to predict and manage fuel costs and electricity prices in the future. In a competitive market, prices inevitably rise and fall and there is some degree of volatility. However, market transparency and efficient risk allocation mechanisms foster competition which allows wholesale and retail suppliers to mitigate this volatility for customers.[8]

It simply is not possible for anyone to accurately predict the perfect moment to buy or sell at the lowest possible price. Therefore, the Commission should focus its efforts on creating stable and predictable market rules designed to establish reliable

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[6] It is important to note that high prices that emerge from lifting price caps are being blamed on competition, when precisely the opposite is true: price caps are the most pervasive form of regulatory intervention and suppress competitive market signals.

[7] CERA, Beyond the Crossroads, 2005; Global Energy Decisions, Putting Competitive Markets to the Test, 2005.

[8] See "*Electricity and Underlying Fuel Prices: A Survey of Non-restructured States*," The Analysis Group, April 2006. .

default service procurement, as well as policies that promote the development of competitive retail markets. A well-designed procurement model should attract both wholesale and retail suppliers and create the downward pressure on prices needed to assure that even non-switching customers are well served by competitive markets in Illinois. Market rules should also encourage participation by existing retail suppliers and entry by new suppliers as well as the development of new and innovative products so that competitive markets can provide benefits to those customers interested in shopping for energy supplies.

There is plenty of evidence that trying to "manage" markets to the perfect outcome is fraught with danger. Illinois should avoid these extremes and maintain a procurement model that balances procurements, particularly for commercial and industrial customers, over a reasonable period such that customers do not face rate shocks or wild price swings but realize the benefits of competition.

2. Demand Response – Questions 1-3
Energy Efficiency/Conservations Initiatives – Questions 1-5

The Commission can and should play a prominent role in encouraging the development of demand response programs and the promotion of energy efficiency and conservation. In fact, the Commission already has initiated two (2) rulemakings on these topics.[9] Time-of-use rates, real time pricing and hourly pricing are all examples of rate structures that can provide incentives for primarily large and medium sized customers, as well as some small commercial customers, to participate in demand side response programs. Allowing these customers to clearly see how they can save money by being

[9] *See* Illinois Commerce Commission, On Its Own Motion, *Rulemaking Regarding Energy Efficiency*, ICC Docket No. 06-0388, May 17, 2006; Illinois Commerce Commission, On Its Own Motion, *Rulemaking Regarding Demand Response*, ICC Docket No. 06-0389, May 17, 2006.

served on one of these types of rate structures is usually all the incentive necessary to encourage participation when they have the ability to do so.[10]

We discussed above one of Constellation NewEnergy's demand response programs for commercial and industrial customers. The following are examples of additional demand response programs that primarily are available to commercial and industrial customers in the marketplace. These additional programs are designed to assist customers' ability to respond to electricity availability and price fluctuations.

- Load curtailment – customers reduce or eliminate their use of discretionary electricity during periods of peak demand and/or when electricity prices are at their highest
- Load displacement – customer shift peak-hour electricity use to off-peak hours
- Short-term fuel substitution – including distributed generation or end use technologies that substitute natural gas for electricity.
- Hourly pricing and real-time pricing – Both of these programs provide customers with retail prices that reflect the changes in the cost of electricity throughout the day. Time-of-use has prices set according to time blocks; real-time pricing uses prices that vary hourly and on a day-to-day basis. A variation of time-of-use pricing is called "critical peak pricing." Critical peak pricing programs use a very high rate charged during only a few hours of peak load days.

Additional Commission actions to encourage demand response should be coordinated with the PJM and MISO so as to ensure that they provide appropriate incentives and effective results. Encouraging greater demand response from larger customers can also only be achieved when PJM and MISO permit scarcity pricing to occur.

[10] *See* Comments of Constellation Energy Group, Inc., Electric Energy Market Competition Task Force, *Notice Requesting Comments ion Wholesale and Retail Competition*, November 18, 2005.

Right now, mitigation mechanisms in PJM and MISO prevent scarcity signals from being sent so there is no true comparison price for customers considering demand response to make an investment decision. In other words, customers will not invest in demand response as long as mitigation prevents price signals about the value of such response from being transparent to the customer. Such transparency about the true value of service, especially in times of scarcity, will, in turn, allow both load and generators to see the same price signals and respond accordingly from both an operational and investment perspective.

In addition, OPSI and OMS could and should be instrumental in promoting demand side enabling technologies such as "smart" meters, internet platforms for communicating real time price signals and forecasting the potential for high price, high load days.

Finally, the deployment of advanced metering technology can be effective in providing consumers with both the real-time price signals and the incentives necessary to elicit timely and appropriate demand response. Not only is such technology important as a means of allowing a customers to react to price volatility and ensuring resource adequacy during periods of tight supply and high demand, but it also can be useful as a means for product differentiation by retail suppliers (e.g., in terms of the types of pricing plans that can be offered). Similarly, "net metering" can allow retail customers to both buy from and sell energy back into the market, which further encourages product differentiation and provides retail customers with additional incentives to actively participate in the retail market.

These types of programs enable customers to adjust their use of electricity in response to changing prices. During periods when prices are high, customers can turn off specific electric equipment, operate their own on-site generation, or shift high demand activities such as manufacturing to times when prices are lower. While the bulk of these programs have been designed for commercial and industrial customers, similar programs have been offered in certain markets to residential customers. As the Commission is aware, residential customers in Commonwealth Edison Company's ("ComEd") service territory have been provided with the opportunity to participate in a real-time pricing billing experiment for the past three years; additionally, ComEd has offered an air conditioning cycling program for residential customers.

III. CONCLUSION

Constellation applauds the efforts of the Commission to thoughtfully consider the steps needed to complete the transition to competitive markets in Illinois. As the Commission has clearly recognized, competitive markets provide a host of benefits to consumers and are the best way to manage rising energy costs. Illinois already has made great strides in bringing the benefits of competition to its citizens; the challenge of successfully completing that task is now before this Commission.

Respectfully submitted,

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